



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

TE/GE EO Examinations

1100 Commerce Street

Dallas, TX 75242

501.07-00

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: December 3, 2010

Number: 201108039

Release Date: 2/25/2011

LEGEND

ORG = Organization name

XX = Date Address = address

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

**CERTIFIED MAIL-RETURN RECEIPT REQUESTED**

Dear :

In a determination letter dated January 19XX, you were held to be exempt from Federal Income tax under section 501 (c)(7) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501 (c)(7) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501 (c)(7) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On November 19, 20XX, you signed Form 6018-A, *Consent to Proposed Action*, agreeing to the revocation of your exempt status under section 501 (c)(7) of the Code.

You are required to file Federal income tax returns for the tax periods(s) shown above. If you have not yet filed these returns, please file them with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted, or unless an examiner's report for income tax liability was issued to you with other instructions. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Director, EO Examinations  
Nanette M. Downing



**DEPARTMENT OF THE TREASURY**

**INTERNAL REVENUE SERVICE**

**TE/GE EO Examinations**

**30 East 7<sup>th</sup> St. Suite 1130B**

**Mail Stop 4925**

**St. Paul, MN 55101**

**TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION**

**Date: November 05, 2009**

**LEGEND**

ORG = Organization name

XX = Date Address = address

**ORG  
ADDRESS**

**Taxpayer Identification Number:**

**Form:**

**Tax Year(s) Ended:**

**Person to Contact/ID Number:**

**Contact Numbers:**

Telephone:

Fax:

**CERTIFIED MAIL – RETURN RECEIPT REQUESTED**

Dear \_\_\_\_\_ :

We have enclosed a copy of our report of examination explaining why we believe an adjustment to your organization's exempt status is necessary.

If you accept our findings, please sign and return the enclosed Form 6018-A, Consent to Proposed Action. We will then send you a final letter modifying or revoking your exempt status.

If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In the event of revocation, you will be required to file Federal income tax returns for the tax period(s) shown above. If you have not yet filed these returns, please file them with the examiner as soon as possible, unless a report of income tax liability was issued to you with other instructions. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

If you do not agree with our position, you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Tract Mediation Services referred to in Publication 3498, do not apply to Exempt Organizations.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in the United States Tax Court, the United States Court of Federal Claims, or the United States District

Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.  
Thank you for your cooperation.

Sincerely,

Sunita Lough  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Form 6018-A  
Report of Examination  
Envelope

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer ORG City, State		Year/Period Ended 12/31/20XX, 12/ 31, 20XX, 12/31/20XX

**LEGEND**

ORG = Organization name      XX = Date      City - city      State - state  
CO-1 = 1<sup>st</sup> COMPANY

**ISSUES:**

Issue 1: Whether the ORG (also known as ORG) is still qualified to be exempt under Section 501(c)(7) of the Internal Revenue Code(IRC)?

Issue 2: Whether the revocation of the organization's tax-exempt status should be applied retroactively to tax year beginning January 1, 20XX?

**FACTS:**

ORG is an exempt organization located in City, State. The main activity of the organization is to run a golf course that is open from April to October each year. The organization was granted its exempt status in January 19XX as an exempt organization under section 501 (c)(7) of the Internal Revenue Code. The letter of exemption explained that a "section 501 (c)(7) is permitted to receive up to 35 percent of its gross receipts, including investment income, from sources outside of its membership without losing its tax exempt status".

The members of the golf course were separated into the following categories: individual, family, spouse, college student, junior rate, spring sales, and fall sales. The organization also allowed non-members to use the course, with these players paying different rates based on the type of golf played: 18 holes, 9 holes or Twilight rate. In addition to non-members paying by type of golf played, the organization maintained books and records for players who used the course that were members of the CO-1 located in City, State. The organization had a reciprocal agreement with this golf course that allowed CO-1 members to play golf at ORG at a discounted rate. In exchange for this reduced rate, members of the ORG played at their course at a discounted rate. The organization did not have any signs at the golf course that stated the golf course was for "members only" and also maintained a website that advertised the golf course was "open to the public".

The organization also received revenue from the sales of food and alcohol sold in the clubhouse. The food sold at the clubhouse was concession type food and not a full service restaurant. The types of food sold were pop, chips, candy, and hot dogs, with the area having one grill and one refrigerator. The organization explained during a tour of the facility that the bar was often the only cash register open since the bartender ran both the bar and food area at the same time. A Pro Shop was also located in the

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clubhouse. The Pro Shop had a separate cash register that recorded membership sales, green fee sales, storage fees, range balls, and Pro Shop items. The Pro Shop items were owned by the Director of Golf, who deducted the sales of these items from the daily total of items sold in the Pro Shop. The income and expenses relating to the Pro Shop items were not recorded on the organization's books and records.

The organization had unrelated business income by allowing non-members to use the golf course, with the annual Form 990-T required to be filed by May 15 following the close of the calendar year. The organization provided copies of the Form 990-T filed in tax years 20XX, 20XX and 20XX. An extension to file the Form 990-T for tax year ending December 31, 20XX has been filed and the return has not been filed as of October 20XX.

During the Field Examination, the organization was asked to produce the daily activity sheets for tax year 20XX showing the number of members and non-members playing each day. The organization's President and Director of Golf did not provide any documentation showing the organization maintained records of the number of member and non-members using the golf course.

The "Income and Expense Allocation worksheet" provided during the Field examination showed the allocation of member and non-member, with the non-member income and expenses reported on the Form 990-T. For member income the worksheet listed annual green fees received from members, winter storage fees, trail fees, green fees from CO-1 members, and % of the other income and expenses of the organization.

The other income and expenses of the organization included range ball sales, golf cart rentals, and clubhouse sales (food and bar). For the non-member allocation the green fees collected from non-members and % of the other income and expenses were allocated on the Form 990-T.

As explained above, the organization did not have documentation to show how the allocation was determined in allocating % of the income to members and % to non-members. For the 20XX tax year, the organization's "Income and Expense Allocation worksheet" also showed the same method of allocating member and non-member income in computing their unrelated business income on the Form 990-T. The organization explained in their response to Information Document Request number 3 that the allocation for future tax years was as follows: "We do not have a reasonable method for going back to determine the extent of the non-member and our member and guest play in relationship to the total business we generated in any year".

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**LAW:**

Section 162 of the Internal Revenue Code (IRC) allows expenses to be deducted that are ordinary and necessary in carrying on any trade or business.

Section 277(a) of the IRC states that "In the case of a social club or other membership organization which is operated primarily to furnish services or goods to members, and which is not exempt from taxation, deductions for the taxable year attributable to furnishing services, insurance, goods, or other items of value to members shall be allowed only to the extent of income derived during such year from members or transactions with members (including income derived during such year from institutes and trade shows which are primarily for the education of members)".

Section 6001 of the IRC provides that every person liable for any tax imposed by the IRC, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time prescribe.

Section 501 (c) (7) of the IRC defines an exempt organization under this section as one that is organized for the pleasure, recreation, and other nonprofit purposes, for its members.

Section 1.501(c)(7)-1 of the Income Tax Regulations (Regs.) provides that, in general, the exemption extends to social and recreation clubs which are supported by membership fees, dues, and assessments. However, a club which engages in business, such as making its social and recreational facilities available to the general public, is not organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, and is not exempt under section 501(a).

Revenue (Rev.) Procedure 71-17 as amended by Public Law 94-568 provides certain gross receipts safe harbors; i.e. Social Clubs may receive up to 35% of their total gross receipts, including investment income, from sources outside of their membership without jeopardizing their tax-exempt status. Within this 35% limit, no more than 15% of a club's gross receipts may be derived from nonmember use of the club's facilities and/or services. If these standards are exceeded, a Social Club will not qualify for exemption pursuant to IRC section 501(c)(7).

Under Rev. Ruling 68-638, 1968-2, the court ruled that a country club organized for the promotion and enjoyment of golf and other sports for its members was not exempt under Section 501 (c )(7) of the Code. The club engaged in golf tournaments that attracted large numbers of spectators. During the tournaments, the club received

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substantial receipts from admission fees, broadcasting rights, parking fees, and food and beverage concessions. The net income received from the tournaments was used for capital improvements and club operating expenses. The Revenue ruling explained that this country club was not exempt for two reasons: (1) "it is engaged in business with the general public by hosting an annual golf tournament to which the public is admitted for a charge, and (2) income from the tournaments is inuring to the benefit of the members in the form of improved facilities and increased services".

### **GOVERNMENT'S POSITION**

Issue 1: *Whether the ORG is still qualified to be exempt under Section 501(c)(7) of the Internal Revenue Code(IRC)?*

A review of the general ledger indicated separate accounts for the green fees received from membership dues, green fees from CO-1, member storage of golf carts, member use of lockers, and member use of trail fees. The general ledger also showed non-member revenue as shown in the accounts for: 18 holes, 9 holes, and Twilight play. The organization's investment income was a de minimis amount and not used in the calculation.

The organization provided books and records for the 20XX tax year that were reviewed during the Field examination. For the 20XX, the organization provided a Trial Balance Worksheet that reported the income and expenses for both tax year 20XX and 20XX. For tax year ending December 31, 20XX an "Income and Expense Allocation worksheet" was provided that showed the amounts allocated to members and to non-members. For the last year, December 31, 20XX, the organization submitted a copy of their general ledger that showed the separate accounts that reported member and non-member amounts received.

The allocation worksheet for tax years 20XX, 20XX, and 20XX showed the organization calculated % of the "bar and food revenue" and % of the "cart and range rentals" as non-member income and % as member income. The organization had no documentation showing how this allocation method had been determined by keeping books and records of member and non-member use of the golf course.

It is the Government's position that the organization must maintain books and records indicating how the member and non-member allocation percentages were determined to be ordinary and necessary expenses under Section 162 of the IRC. Under Section 6001 of the IRC, an organization must provide books and records to document the amounts reported on their Federal tax returns.

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The revenue posted to the general ledger accounts from CO-1 was as follows: \$ \$ \$ \$ for tax years 20XX, 20XX, 20XX, and 20XX respectively. A review of the Form 990-T allocation worksheet indicated the organization included the revenue from this outside golf course as member income. Since the revenue was not from members, it is the Government's position that this income is "non-member" income since no membership dues have been collected from these individuals.

The following chart shows the organization's allocation of % and % for "member" and "non-member" clubhouse and cart/range rentals, revenue from CO-1 (non-member), green fees collected from non-members, and revenue received from members:

<b>Revenue Type</b>	<b>12/31/20X</b>	<b>12/31/20XX</b>	<b>12/31/20X</b>	<b>12/31/20XX</b>
Member revenue	X		X	
Non-member revenue				
Total revenue				
Member percentage				
Non-member percentage				
Non-member use exceeds 15%?	YES	YES	YES	YES
<b>Dual revenue sources</b>	<b>12/31/20X</b>	<b>12/31/20XX</b>	<b>12/31/20X</b>	<b>12/31/20XX</b>
Bar and Food revenue, total Form 990-T allocated with 15% Amount allocated to members	X		X	
Cart and range rentals Non-member of 15% Member of 85%				
CO-1				
Non-member green fees				

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Member revenue per books and records

Locker

Handicap

Range fees (ind. & family)

Trail fees

Cart storage

Individual dues

Fall dues

Spring dues

Spouse dues

Junior dues

College dues

Family dues

**TOTAL:**

The above calculation used the allocation as reported by the organization, % to members and % to non-members for revenue received from "bar and food" and "cart and range rentals". As stated above, the organization must use a reasonable method to allocate the percentage of use by members and non-members. For ORG a reasonable method would be the rounds of golf played by non-members and non-members, with this percentage obtained by a daily count of rounds of golf maintained by the organization as documentation for their Form 990-T completion.

The safe harbor in Rev Procedure 71-17 as amended by Public Law 94-568 allows ORG to receive only % of their receipts from members, and a total of % with investment income. The above chart showed the revenue received from members and non-members, with the non-member percentage ranging from % to % in tax years 20XX through 20XX. The non-member use of the organization's golf course consistently exceeded %, even with the allocation of % and % which was calculated based upon no documentation.

The organization's website stated that the golf course was open to the public and had no signs stating that the golf course was open only to members. It is the Government's position that the organization is operating a golf course as one that is not a membership organization as required for an exempt organization under Section 501 (c)(7) of the Internal Revenue Code (IRC). It is the Government's position that the organization can no longer be exempt under Section 501 (c)(7) of the IRC since the golf course is open to non-members and the revenue received from non-members exceeds the allowable amount under Revenue Procedure 71-17.

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**Issue 2:**

*Whether the revocation of the organization's tax-exempt status should be applied retroactively to tax year beginning January 1, 20XX?*

Since the first year under examination is the year ending December 31, 20XX, it is the Government's position that the exempt status should be revoked back to January 1, 20XX.

**TAXPAYER'S POSITION**

The taxpayer was advised during the Field examination that the non-member amounts exceeded the allowable % and they agree to revocation of the exempt organization. The organization has explained in their replies to Information Document Requests (IDR) that they will file Form 1120's for the tax years under examination.

**CONCLUSION**

Based on the review of the income received by ORG, the organization's exempt status should be revoked since its income exceeded the maximum % allowed under Section 501 (c)(7) of the Internal Revenue Code. The organization will submit the annual Form 1120's for tax years ending December 31, 20XX, December 31, 20XX, and December 31, 20XX to the Revenue Agent.

Under Section 277 of the Internal Revenue Code, the organization cannot offset a loss from members against the income from the non-member activities on their Form 1120. A loss on the member activity can only be carried forward to a later year to be taken against member income.

The organization will complete the Form 1120's using a reasonable method of allocation for member and non-member income and expenses.